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ABSTRACT

In response to the rising costs of health care and large increases in insurance premiums, a study was conducted at Lakeshore Technical Institute (LTI) to investigate the feasibility of using a self-funded health insurance plan at the college. Data were obtained through a literature review; telephone and on-site discussions with a personnel manager, health representative, and health insurance consultants; and a survey of personnel managers in organizations that had self-funded health insurance plans. The study revealed a number of important factors and criteria to be weighed in decisions related to self-funded health insurance, including type and size of the organization; types of self-funded insurance plans; current and projected financial positions and ability to finance; savings on health care costs; level of savings needed to implement the plan; liability insurance; and successful experience in implementing the plan. When these factors were considered, it was concluded that LTI was in a favorable position to self-fund its insurance plan, based on its size and stable financial position. However, it was concluded that the recommendation to self-fund the plan needed further analysis. References and the survey instrument are appended. (EJV)

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Evaluating Self-Funded Health Insurance for the Lakeshore Technical Institute as a Cost-Containment Measure

by

Karen E. Holstein

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A research report

submitted in partial fulfillment

of the requirements for the degree of

Bachelor of Science in Management

Cardinal Stritch College

May 1987

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Executive Summary

Over the years from 1981 to 1985, Lakeshore Technical Institute had experienced several substantial increases in the health insurance premium. Rising health care costs and large increases in premiums made it difficult to continue financing the health insurance plan while maintaining the same level of benefits. As a result, the administration was interested in investigating alternative measures for health insurance cost containment. This study was conducted to investigate the self-funded health insurance plan as one alternative measure.

Data for the report was obtained from a number of sources. Books and periodicals found in the literary review provided the information base. Several telephone and on-site discussions with a personnel manager, health representative, and health insurance consultants provided the bases for questionnaire development. The questionnaire requested information regarding factors used in self-funding decisions. It was mailed to personnel managers in business, industry, educational, and government organizations that had self-funded health insurance plans. The results were tabulated for each item.

Results of the study indicated that there were a number of important factors and criteria related to the decision making process in self-funding the health insurance plan. These

included: type and size of organization, types of self-funded health insurance plans, financial position (current and projected) and ability to finance, savings on health care costs, level of savings needed to implement the plan, liability insurance, and successful experience in implementing the self-funded health insurance plan.

A number of important conclusions resulted from the study. Lakeshore Technical Institute is of a size that can handle the self-funding risk. The financial position, current and projected, indicated stability in assuming the risk. Governmental organizations have been successful in fiscal financial management of the self-funded health insurance plan. And, self-funding the health insurance plan is a viable alternative to containing health care costs.

Lakeshore Technical Institute is in a favorable position to self-fund the health insurance plan. The recommendation to self-fund includes further analysis. Considerations should be given to: partial self-funded health insurance, an Administrative Services Only plan, a type of legal reserve fund that meets governmental accounting guidelines, amounts of specific and aggregate stop-loss insurance be determined by historical data analysis, and that a minimum savings level of 8 percent be considered in the decision to self-fund.

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Introduction

Authorization for Research

The assistant director, Dennis J. Ladwig, requested the study to determine the feasibility of implementing self-funded health insurance at the Lakeshore Technical Institute (LTI). The primary focus of the study was self-funded health insurance as a cost-containment measure. A commitment of resources including secretarial, computer and specialized staff services, postage, materials, supplies, and telephone was made to complete the study.

Purpose of the Study

The purpose of this study was to determine whether the self-funded health insurance plan was a viable alternative for LTI. The decision was based on the significant difference in cost between the conventional health insurance plan and the self-funded health insurance plan. Additionally, the decision was made to maintain the existing level of health care benefits for the employees at LTI.

Statement of the Problem

LTI was finding it more difficult to continue financing existing levels of health care benefits to its employees. Rising health care costs had resulted in increased premiums. At the same time, revenue from a variety of sources had been declining. This

was increasing the amount of money that had to be obtained from local property tax.

Three specific subproblems were identified within the problem.

1. The identification of important factors and criteria contributing to rising health care costs.

2. The determination of LTI's ability to implement a self-funded health insurance plan.

3. The determination of the difference in cost impacts between the conventional health insurance plan and the self-funded health insurance plan.

Scope of the Study

The scope of this study involved three components. The first was the analysis of LTI's health insurance income and expenses for the period from 1981 to 1985. The second was the determination of LTI's financial ability to self-fund the health insurance plan. The third was the comparison of similar organizations in making provisions for self-funded health insurance in the central and eastern areas of Wisconsin.

Limitations

The recommendations were limited to the following:

1. Organizations that were similar in number of employees to that of LTI.

2. Organizations that provided health insurance benefit plans in which all or most of the health insurance premium was paid by the organization.

3. Organizations that obtained funding from a variety of sources.

4. Organizations that implemented a partially self-funded health insurance plan.

Methodology

In order to obtain data for this study, the following methodology was used:

1. Review of literature using a data base search and University of Wisconsin library resources.

2. Completion of interviews and discussions to obtain significant factors to be included in the study or in the determination of self-funded health insurance decisions.

3. Administration of a survey of similar organizations.

4. Tabulation of survey results and grouping into appropriate categories.

5. Analysis of financial data obtained from the survey results and internal financial operations.

6. Development of recommendations regarding the implementation of a self-funded health insurance plan at LTI.

Sources of Data

Areas of data required for the study of self-funded health insurance were obtained by reading publications and reference books identified by a DIALOG data base search. The review of literature focused on the following three areas which provided substance to the investigation: (1) history of health insurance that included provisions, cost sharing, and factors contributing to rising health care costs, (2) self-funded health insurance, and (3) financing and cost savings.

In order to understand why self-funded health insurance evolved as an alternative to conventional health insurance, it was necessary to go back to the beginning of the health insurance industry in the United States. According to Morton (1984, p. 13), health insurance became available to employers and individual policyholders in the 1930s. The main purpose of providing health insurance afforded sick individuals medical expense protection. Provisions for paid benefits included hospitalization, surgical, physician, and related medical expenses. Consequently, health insurance economically protected the individual against the consequences of financial loss due to costs of medical care.

In an article by Stone and Reitz (December 1984, p. 27), health care benefits had been provided in one form or another since the depression. Initially, both the employer and the

employee shared equally in the costs. Over the years, employers attempted to maintain a satisfied work force by providing increased benefits to both union and nonunion employees. The increased cost of providing these benefits was absorbed by the employer as a result of collective bargaining. The pattern of upgrading employee benefits continued into the 1970s when national health welfare policies also contributed to increased costs. During this time, employers and citizens were obligated to provide not only "life's necessities" but also to provide for sophisticated medical services of the highest quality. These services were provided to all individuals regardless of their ability to pay. As a result, health care costs rose steadily in the past quarter century.

Four major factors had significantly contributed to increased health care costs. Inflation was the primary factor. According to Stone and Reitz (December 1984, p. 28), "In 1965 a variety of medical goods and services cost $100, and by 1981 this cost increased to $329." During this 16-year period, medical costs increased at an annual rate of 7.7 percent, an annual average of 1 percent above the Consumer Price Index (CPI).

The second factor was the cost of improved technology for medical testing and for catastrophic illness. Because patients

paid for little if any of these medical costs, utilization of medical services increased.

The third factor was the physician. Always in complete control of the patient's care, physicians' decisions about hospitalization, surgery, and medical services accounted for almost 70 percent of health care spending.

The fourth factor was providing medical care to the increasing number of elderly patients and the double cost in treating them. Under the 1982 Tax Equity and Fiscal Responsibility Act (TEFRA), the national Medicare and Medicaid program benefits were reduced, thus shifting more benefits and related costs to business and industry. The employer currently has the obligation to provide health care benefits to older workers, which had been previously covered under Medicare.

LTI had provided conventional health insurance to its employees for many years. In addition, LTI absorbed 95 percent of the health insurance premium cost as a result of collective bargaining. To address rising health care costs, LTI changed health insurance carriers in 1980, which either reduced or stabilized costs for two years. Several years later, under government mandate, LTI offered a Health Maintenance Organization (HMO) plan. This plan deviated from the conventional fee-for-service, group rated, health insurance plan. The HMO concept

incorporated a community experience rated plan through designation of a controlled medical services environment. Only participating hospitals and physicians provided medical services. The overall plan concept reduced health insurance plan costs. Another HMO was introduced in 1985. Minimum utilization of these plans had occurred because of union strategies. The only other alternative to containing health care costs was to examine the feasibility of implementing a self-funded health insurance plan.

A self-funded health insurance plan is actually a modified conventional health insurance plan. Margolin (October 1982, p. 79) alleged that self-funding was a product of diversifying traditional insurance functions. The functions included (1) providing administrative services (including processing claims), (2) establishing reserves to pay claims from employer premiums, and (3) distributing funds to employee-claimants. All of the above were found in self-funded health insurance. What changes in self-funding is the shift in responsibility from the carrier to the employer in administering the insurance functions.

This investigation was confined to partially self-funded health insurance plans because of the size of LTI and the lack of available staff and resources to fully self-insure. A partially self-funded health insurance plan can best be described by the shift of risk from the carrier back to the organization

(employer). This risk covered claims incurred and claims paid. A reserve or trust had to be set up by the employer to cover this liability. In addition, the employer could also purchase stop-loss insurance from a third-party insurer to protect the organization against catastrophic losses. Also, other administrative services could be purchased, such as claims payment, development and printing of benefit booklets, actuarial assistance, and monitoring of physician and hospital charges.

Another concern for employers was financing a self-funded health insurance plan which affected cost savings. As Fedler, Hadley, and Holahan (1980, p. 99) note, the ability to finance a health insurance plan had resulted in the limited choice of plans offered to employees. In addition, unequal employer contributions across plans and the tax-exempt status of employer contributions to premiums had affected employee attitudes about their benefits. These issues had diminished employee sensitivity to the cost of insurance and had encouraged the purchase of comprehensive coverage. This had resulted in protecting the consumer against medical care costs.

Six elements of health insurance cost had been identified by Todd (February 1984, p. 28) that needed to be considered when financing a self-funded health insurance plan. They were: (1) claims paid during the policy year, (2) reserves for excessive

claims, (3) reserves for incurred but unpaid claims, (4) state premium taxes, (5) administrative expenses, and (6) profit. The following year's premiums will be increased whenever premiums fall short of covering these elements.

Employers should look at these elements and their associated costs. One savings area is lost interest on prepaid premiums. When a new plan is started, generally only 5 percent to 10 percent of the first year's claims are paid in the first three months. The insurer collects 25 percent of the annual premium during this period of time. The difference between the amount of premiums received and the amount of claims paid is placed into reserves for claims incurred. The employer never receives interest on these reserves under a conventional health insurance plan.

Another savings area, according to Ryals (July 1985, p. 43), occurred in retention. Approximately 10 percent of the total premium cost involves the margin for claim fluctuation. Cost savings may come from a retrospective premium rating which means that a lower premium can be collected by the insurer during the year. Should experience warrant, the employer may have to pay the full premium at year end. This would allow the employer the use of 10 percent monies during the year. A "prospective premium rating" could also save the employer some monies. The employer pays a discounted premium off the 10 percent margin. Should

experience warrant, the employer may have to pay the full premium at year end. The ultimate result, however, is that the employer can earn more interest on this money than the insurance company.

State premium taxes was another cost savings area. Under a fully insured plan, 2 percent of the premium is paid by the insurer for state taxes. Under a self-funded plan, employers are not required to pay state premium taxes in most states.

A fourth cost savings area was the approach an employer took to provide funds for a self-funded plan. One method included depositing funds on an "as needed" basis to pay claims and expenses as they occurred, while retaining excess funds in the company cash flow. The other method required a large initial deposit and regular monthly deposits into a 501(c)(9) trust and investment of funds until they were needed to pay actual claims. The use of the 501(c)(9) trust exempts the employer from paying tax on the interest earnings from the deposits.

A fifth cost savings area was administrative expenses. Employers can streamline benefit programs by offering only one plan. In addition, an employer might consider the use of a third-party insurer to handle claims processing.

Two other cost savings areas were identified in the Employee Benefit Plan Review (June 1982, p. 44). The first area was cash flow flexibility. With a fully insured plan, the insurance

company determines when premiums are due. In a self-funded plan, the employer has control over this cash flow. The second area was control over float. Benefit checks can be held for a period of time which allows the employer use of this money for several weeks longer.

Many advantages of making a change to self-funded health insurance have been discussed. Employers, however, also need to be cognizant of potential disadvantages of self-funding. Clifford (May 1982, p. 30) argues that if a trust for reserves is set up, income tax forms must be filed even though the trust is a nontaxable entity. Additional liability protection against claim disputes or lawsuits may require more legal counsel or services. Finally, the employer will have greater financial responsibility for assuming the risk of claims paid and claims incurred.

Fletcher (December 1984, p. 14) described other disadvantages. Many times self-funding is looked at for the wrong reason, such as when the employer is having financial difficulties and is looking for ways to improve the cash flow. Also, unless adequate stop-loss insurance is purchased, a claim for a catastrophic illness could consume a lot of the employer's assets. Consequently, if the business closed its doors or lost its stop-loss insurance, employees would be unprotected.

Much literature has been written about self-funding a health insurance plan. This has been attributed to the significant increase in health care costs in the past quarter century. These costs have been passed along to employers and individual policyholders. The economy has drastically changed in the last ten years, and employers can no longer financially handle the burden alone. Self-funding offers many attractive cost savings features which appear to be manageable and financially rewarding. LTI is considered to be a smaller employer. In other words, approximately 250 plans are financed as a benefit for employees. Until several years ago, implementing a self-funded plan was considered a tremendous risk for this size group. According to a health plan survey acknowledged in Business Insurance (January 1985, p. 12), 33.6 percent of companies surveyed with less than 500 employees were self-insured. This trend seems to be popular in the 1980s. After completing the review of literature, self-funding the health insurance plan at LTI appears to be a viable alternative to cost containment.

Background

In spring of 1980, Lakeshore Technical Institute was faced with a significant health insurance premium increase. Rather than finance this increase, LTI changed health insurance carriers. The premiums were contained until the loss experience was established

as a new group. From 1982 to 1986, LTI had experienced several significant premium increases; however, the organization remained with the same health insurance carrier. Other alternatives to contain rising health care costs were implemented to include two health maintenance organization plans. The resulting cost savings had not reached the level desired by the LTI administration. Because of negotiated agreements, no deviation from the conventional fee-for-service health insurance plan was possible. As a result, LTI wanted to consider another alternative--that of self-funded health insurance.

Definition of Terms

Administrative Services Only Contract - a self-funded health insurance plan whereby the contract is written by the organization, and the carrier/insurer agrees to abide by the organization's contractual requirements.

Aggregate Stop-Loss Insurance - insurance purchased by the organization that caps the total annual payout for health insurance benefits, usually at an amount calculated between 110 percent and 125 percent of the organization's total annual estimated health insurance claims cost.

Cash Flow - claims paid from daily operating income and borrowing money when necessary to pay claims.

Claims Incurred - health benefit services rendered during the specified time period but not paid.

Claims Lag - the period of time between the health benefit services rendered date and the claim paid date.

Claims Paid - health benefit services rendered and paid during the specified time periods.

Conventional Health Insurance Plan - a health insurance plan underwritten by a carrier who collects a premium (usually experience rated) from the organization, underwrites the risk of unexpected fluctuations in claims, and provides administrative services. This plan is also referred to as a fee-for-service plan.

Cost-Plus Contract - a self-funded health insurance plan whereby the contract is written by the carrier, and the organization assumes the regulations imposed by the carrier and the State Insurance Commissioner.

Expenses - payments made for health insurance claims, administrative costs, and incurred claims not paid.

Income - the amount of premium paid to the carrier by the organization for health insurance coverage.

Joint Benefit Administration - a self-funded health insurance plan provided for union-represented employees that is jointly administered by the organization and the union.

Minimum Premium Plan - a plan similar to a conventional health insurance plan with the exception that the carrier and the organization agree to assume a specified share of the claims liability. Generally, the organization's liability is 10 percent of expected claims.

Reserves - the money set aside to cover outstanding expenses.

Self-Administered Contract - a self-funded health insurance plan that is written and administered by the organization, provides its own claims administration, and no carrier is involved.

Self-Funded Health Insurance Plan - a self-funded health insurance plan whereby the organization assumes the risk for claims incurred and claims paid and contracts with a third party insurer/administrator to provide administrative services only.

Specific Stop-Loss Insurance - insurance purchased from a carrier in conjunction with claims administration that limits the self-insured organization's liability for paying individual claims.

Stop-Loss Insurance - insurance purchased from a carrier in conjunction with claims administration that protects the self-insured organization against excessive claims, either on an aggregate basis or on an individual case basis.

Third-Party Insurer/Administrator - any company that an organization contracts with to pay insurance claims and performs a full complement of administrative services.

501(c)(9) Trust Fund - a monetary reserve fund established by the organization using Internal Revenue Code guidelines to provide reserve funds for self-funded health insurance. The employer contributions are tax-deductible as a cost of doing business. Also, earnings on these reserves are tax-exempt.

Statement of the Results

The results of the study include the following hypotheses based on past experiences, trends, and projections of futurists:

1. A number of organizations similar in size have implemented the self-funded health insurance plan.

2. Self-funding the health insurance plan is a viable alternative to containing health care costs.

3. The self-funded health insurance plan is a viable alternative in business, industry, educational, and government organizations.

4. Similar types of organizations will have similar health insurance costs and abilities to finance these costs.

5. There will be an average health insurance premium increase of approximately 10 percent for each of the years from 1987 through 1990.

6. Health care costs will increase by an average of 8 percent for each of the years from 1987 through 1990.

Plan of Presentation

The plan of presentation in this study follows the accepted plan for research studies. The self-funded health insurance study at LTI will be presented in the following manner:

1. Introduction.
2. Review of the literature.
3. Procedures used in collecting the data.
4. Results of the study.
5. Analysis of the pertinent information identified.
6. Discussion of the results, analyses, and implications.
7. Summary.
8. Conclusions of the study.
9. Recommendations to the LTI administration.

Presentation of Procedures and Results

In order to determine whether the self-funded health insurance plan was a viable health insurance alternative for the Lakeshore Technical Institute, descriptive data was needed for the study. A review of the literature identified three major areas of information: (1) history of health insurance that included provisions, cost sharing, and factors contributing to rising health care costs; (2) factors to consider in self-funded health insurance decisions; and (3) financing and cost savings. Several telephone and on-site discussions with a personnel manager, health insurance representative, and two health insurance consultants provided additional information about self-funded health insurance plans.

Nine procedures were included in the study.

1. The population and sample were identified.
2. The questionnaire was developed.
3. The definition of terms and the cover letter were developed.
4. The questionnaire, definition of terms, and the cover letter were mailed.
5. The results were tabulated utilizing the LTI computer programs.
6. The results were analyzed.

7. The LTI health insurance income and expense figures were collected for each of the years 1981 through 1986.

8. Analysis and projections for LTI's health insurance income and expenses were made.

9. A determination was made as to the potential future impact on the LTI health insurance plan costs.

Population and Sample

Organizations representing business, industry, education, and government in the central and eastern areas of Wisconsin comprised the population for the study. The areas identified had similar size demographic characteristics to that of LTI. Information about the organizations was obtained from a variety of sources. These included the 1986 Classified Directory of Wisconsin Manufacturers, 45th Edition; Standard Industrial Classification (SIC) Manual, 1972; Sheboygan Area Chamber of Commerce Industrial Directory, 1986; health insurance representatives; the East-Central Vocational, Technical and Adult Education (VTAE) District Consortium executive secretary; and local school district and government agencies' personnel. After reviewing all the sources of information, 107 organizations were selected to participate in the study.

A cover letter (Appendix A) was developed to explain LTI's effort to review alternatives to contain health care costs. An

addressed, postpaid reply card (Appendix B) was developed to collect related basic data regarding the types of insurance coverage provided by the organizations. The approximate numbers of employees and health insurance subscribers were also requested. The letter and card were mailed to the 107 organizations on April 17, 1986, with an April 25, 1986, return date requested.

Of the 107 organizations selected to participate in the study, 70 (65 percent) responded. Review of the nonrespondents did not reveal a particular bias existing among them. Of the 70 respondents, 24 reported providing self-funded health insurance with the following characteristics:

1. Similarity of size (150 to 450 employees).
2. Similarity in number of subscribers (150 to 450).
3. Contracts for specific types of self-funded health insurance: administrative services only, cost-plus, minimum premium, or third-party insurer/administrator.

This group of 24 organizations comprised the final sample.

Questionnaire Development

Development of a self-funded health insurance questionnaire was based on information obtained from several sources. A number of questions were developed from the literature review to be used in the on-site interview. The personnel manager at Donohue Architects and Associates Inc. was interviewed because of a peer

professional relationship and the fact that the organization had implemented a self-funded health insurance plan in 1982. The interview provided a number of items for the questionnaire. Additional items were obtained as a result of discussions with the Blue Cross/Blue Shield United of Wisconsin Insurance Company representative. Other items resulted from discussions with two health insurance consultants from Don F. Jabas Associates Inc. and E and E Benefits.

The questionnaire (Appendix C) was developed as a result of information obtained from all of the above information sources. The questionnaire contained 21 items grouped into 11 categories of:

1. Type of organization.
2. Number of employees eligible for the health insurance benefit.
3. Type of self-funded health insurance plan and number of years in the plan.
4. Major factors used in selecting self-funded health insurance.
5. Level of savings and cost savings factors.
6. Methods of financing.
7. Stop-loss insurance protection.
8. Frequency of premium increases or decreases.

9. Health insurance as a negotiable item.

10. Implementation problems encountered.

11. Services provided by the third-party insurer/ administrator.

The validity and the reliability of the instrument were addressed by submission to an outside organization, a health insurance company representative, an internal financial manager, and a curriculum specialist. Modifications were made in accordance with reactions and suggestions.

The study included a mail-type survey. Most of the items required the respondent to check the appropriate choice and provided an opportunity for comment. Several items required narrative responses.

A definition of terms was developed to assist the respondent and to ensure that respondents used the same definitions as bases for responses. The definition of terms (Appendix D) included definitions for 13 key phrases describing self-funded health insurance. The phrases were descriptive of types of self-funded health insurance, financing methods, liability insurance, and third-party insurers. The cover letter (Appendix E) thanked the respondent for responding to the initial inquiry, explained the purpose of the study at LTI, and provided instructions for completing the questionnaire. The importance of the questionnaire

return date and the telephone follow-up, if needed, was explained. The letter also thanked the respondent for participation in the study.

The cover letter, definition of terms list, and the questionnaire were mailed to the 24 organizations on May 5, 1986. A return date of May 16, 1986, was requested. Initial survey returns reflected a 66.5 percent response. Follow-up of survey nonrespondents was made to ensure a greater return rate. Telephone calls were made to clarify information provided in the questionnaire. As a result, an additional six respondents were obtained. Usable surveys totalled 22 (92 percent) of the sample.

Tabulation of Data

The responses to questions that were narrative in nature were manually summarized for analysis. The majority of questions had responses that were selected from provided choices. These were reviewed and prepared for computer input. Tabulations of the number of respondents indicating each choice were made. Statistical analyses were conducted by organization category for each choice. The use of the mean and standard deviation were used where applicable. In other instances, when a comparison or ranking of two items was necessary, a graph was used to demonstrate the results.

Results

The purpose of the study was to determine whether the self-funded health insurance plan was a viable health insurance alternative to LTI. The instrument was mailed to 24 organizations of which 22 (92 percent) completed the questionnaire and are incorporated into the study. The results are illustrated in 22 tables with a discussion included.

Table 1 indicates responses from each of the four major categories: business, industry, education, and government. The 14 responses from industry represented approximately two-thirds of the total. The four responses from educational organizations

Table 1

Types of Organizations

Organization Type	Frequency of Responses	Percent of Responses
Business	2	9
Industry	14	64
Education	4	18
Government	2	9
Total	22	100

represented approximately one-sixth of the total. The responses from business and government organizations represented approximately one-sixth of the total. It was determined that self-funded health insurance plans were used to a considerably large extent by industrial organizations.

Table 2 indicates the number of employees eligible for the health insurance benefit plan. Of the 22 organizations surveyed, 36 percent had between 350 to 449 eligible employees. Those with 150 to 249 and 250 to 349 eligible employees each represented 23 percent, and those with over 449 eligible employees represented

Table 2

Employees Eligible for the Health Insurance Benefit

Size of Organization	Number of Responses	Percent of Responses
150 to 249	5	23
250 to 349	5	23
350 to 449	8	36
Over 449	4	18
Total	22	100

18 percent. There was a relatively uniform distribution of organizations with various numbers of eligible employees in the study.

Table 3 indicates the extent of the use of each of the types of self-funded health insurance plans provided by the organizations surveyed. Responses indicated that 55 percent had administrative services only (ASO) plans. Another 18 percent had cost-plus plans. In addition, 9 percent had minimum premium

Table 3

Types of Self-Funded Health Insurance

Types	Number of Responses	Percent of Responses
Administrative Services Only (ASO)	12	55
Cost-Plus	4	18
Minimum Premium	1	5
Self-Administered	2	9
Other:	3	13
Total	22	100

plans; and 5 percent had self-administered plans. Other was described as third-party insurer/administrator and represented 13 percent.

Tables 4 through 12 indicate the importance of each of the nine factors in selecting the type of self-funded health insurance plan. Each factor was ranked in order of importance from most important to not applicable. The choices were five, four, three, two, one, and zero: five for most and one for least with zero for not applicable.

Table 4 indicates the importance of elimination of state premium taxes as a factor. Of the organizations surveyed, 50 percent indicated that elimination of state premium taxes was not applicable in the organization's decision. Average and low importance were indicated by 18 percent of the respondents respectively. The choices most and least were indicated by fewer than 10 percent of the respondents. The high choice was not indicated by any of the respondents. The mean of the responses (not including "0's") was 2.4 with a standard deviation of 1.1, which indicates that the importance of this factor was between low and average.

Table 4

Elimination of State Premium Taxes

Ranking of Importance	Number of Responses	Percent of Responses
Most (5)	1	5
High (4)	0	0
Average (3)	4	18
Low (2)	4	18
Least (1)	2	9
Not Applicable (0)	11	50
Total	22	100
Mean 2.4 (Not Including "0's")	Standard Deviation (Not Including "0's")	1.1

Table 5 indicates the importance of tax-free earnings on reserves as a factor. Of the organizations surveyed, 50 percent indicated that tax-free earnings on reserves was not applicable in the organization's decision. High importance was indicated by 18 percent of the respondents. Low importance was indicated by 13 percent of the respondents. The choices most, average, and least were indicated by fewer than 10 percent of the respondents

respectively. The mean of the responses (not including "0's") was 3.1 with a standard deviation of 1.2. This indicates that the importance of this factor was between high and average.

Table 5

Tax-Free Earnings on Reserves (Monies Set Aside for Payment of Claims)

Ranking of Importance	Number of Responses	Percent of Responses
Most (5)	1	5
High (4)	4	18
Average (3)	2	9
Low (2)	3	13
Least (1)	1	5
Not Applicable (0)	11	50
Total	22	100
Mean 3.1 (Not Including "0's")	Standard Deviation (Not Including "0's")	1.2

Table 6 indicates the importance of financial reserve considerations and flexibility as a factor. Of the organizations surveyed, 36 indicated that the financial reserve considerations

and flexibility were not applicable in the organization's decision. High importance was indicated by 24 percent of the respondents. The choices average and low importance were indicated by 13 percent of the respondents respectively. The choices most and least were indicated by less than 10 percent of the respondents respectively. The mean (not including "0's") was

Table 6

Financial Reserve Considerations and Flexibility

Ranking of Importance	Number of Responses	Percent of Responses
Most (5)	2	9
High (4)	5	24
Average (3)	3	13
Low (2)	3	13
Least (1)	1	5
Not Applicable (0)	8	36
Total	22	100
Mean 3.3 (Not Including "0's")	Standard Deviation (Not Including "0's")	1.2

3.3 with a standard deviation of 1.2. This indicates that the importance of this factor was between high and average.

Table 7 indicates the importance of tax-exemption of investment earnings as a factor. Of the organizations surveyed, 60 percent indicated that the tax-exemption of investment earnings was not applicable in the organization's decision. High importance was indicated by 13 percent of the respondents. The

Table 7

Tax-Exemption of Investment Earnings

Ranking of Importance	Number of Responses	Percent of Responses
Most (5)	2	9
High (4)	3	13
Average (3)	2	9
Low (2)	2	9
Least (1)	0	0
Not Applicable (0)	13	60
Total	22	100
Mean 3.6 (Not Including "0's")	Standard Deviation (Not Including "0's")	1.1

choices most, average, and low were indicated by fewer than 10 percent of the respondents. The least choice was not indicated by any respondents. The mean (not including "0's") was 3.6 with a standard deviation of 1.1. This indicates that the importance of this factor was between high and average.

Table 8 indicates the importance of accessibility to and use of claims data for decision making as a factor. Of the

Table 8

Accessibility to and Use of Claims Data for Decision Making

Ranking of Importance	Number of Responses	Percent of Responses
Most (5)	1	5
High (4)	5	24
Average (3)	9	40
Low (2)	3	13
Least (1)	2	9
Not Applicable (0)	2	9
Total	22	100
Mean 3.0 (Not Including "0's")	Standard Deviation (Not Including "0's")	1.0

organizations surveyed, average importance was indicated by 40 percent of the respondents. High importance was indicated by 24 percent of the respondents. Low importance was indicated by 13 percent of the respondents. The choices most and least were indicated by less than 10 percent of the respondents. The accessibility to and use of claims data was not applicable in 9 percent of the organization's decisions. The mean (not including "0's") was 3.0 with a standard deviation of 1.0. This indicates that the importance of this factor was average.

Table 9 indicates the importance of the elimination of many carrier charges as a factor. Of the organizations surveyed, high importance was indicated by 34 percent of the respondents. The choices most and average were indicated by 24 percent of the respondents respectively. Low importance was indicated by 13 percent of the respondents. The least choice was not indicated by any respondents. Five percent of the respondents indicated that elimination of many carrier changes was not applicable to the organization's decision. The mean (not including "0's") was 3.7 with a standard deviation of 1.0. This indicates that the importance of this factor was between high and average.

Table 9

Elimination of Many Carrier Charges

Ranking of Importance	Number of Responses	Percent of Responses
Most (5)	5	24
High (4)	8	34
Average (3)	5	24
Low (2)	3	13
Least (1)	0	0
Not Applicable (0)	1	5
Total	22	100
Mean 3.7 (Not Including "0's")	Standard Deviation (Not Including "0's")	1.0

Table 10 indicates the importance of greater flexibility in determining the employee contribution level as a factor. Of the organizations surveyed, average importance was indicated by 30 percent of the respondents. Greater flexibility in determining the employee contribution level was not applicable in 24 percent of the organization's decision. The choices high and average were indicated by 18 percent of the respondents respectively. The

choices most and least were indicated by less than 10 percent of the respondents respectively. The mean (not including "0's") was 2.8 with a standard deviation of 1.1. This indicates that the importance of this factor was between average and low.

Table 10

Greater Flexibility in Determining Employee Contribution Level

Ranking of Importance	Number of Responses	Percent of Responses
Most (5)	1	5
High (4)	4	18
Average (3)	4	18
Low (2)	7	30
Least (1)	1	5
Not Applicable (0)	5	24
Total	22	100
Mean 2.8 (Not Including "0's")	Standard Deviation (Not Including "0's")	1.1

Table 11 indicates the importance of savings on health care costs as a factor. Of the organizations surveyed, most importance was indicated by 67 percent of the respondents. High importance

was indicated by 18 percent of the respondents. The choices average, low, and not applicable were indicated by less than 10 percent of the respondents respectively. The choice least importance was indicated by none of the respondents. The mean (not including "0's") was 4.6 with a standard deviation of 0.8. This indicates that the importance of this factor was between most and high.

Table 11

Savings on Health Care Costs

Ranking of Importance	Number of Responses	Percent of Responses
Most (5)	15	67
High (4)	4	18
Average (3)	1	5
Low (2)	1	5
Least (1)	0	0
Not Applicable (0)	1	5
Total	22	100
Mean 4.6 (Not Including "0's")	Standard Deviation (Not Including "0's")	0.8

Table 12 indicates the importance of employee acceptance of the self-funded health insurance plan as a factor. Of the organizations surveyed, 29 percent indicated that employee acceptance of the self-funded health insurance plan was not applicable to the organization's decision. The choices high and average importance were indicated by 18 percent of the respondents respectively. The choices low and least were indicated by

Table 12

Employee Acceptance

Ranking of Importance	Number of Responses	Percent of Responses
Most (5)	2	9
High (4)	4	18
Average (3)	4	18
Low (2)	3	13
Least (1)	3	13
Not Applicable (0)	6	29
Total	22	100
Mean 2.9 (Not Including "0's")	Standard Deviation (Not Including "0's")	1.3

13 percent of the respondents respectively. Most importance was indicated by less than 10 percent of the respondents. The mean (not including "0's") was 2.9 with a standard deviation of 1.3. This indicates that the importance of this factor was between average and low.

Table 13 indicates the level of savings needed to successfully implement the self-funded health insurance plan.

Table 13

Level of Savings Needed to Successfully Implement Self-Funded Health Insurance

Percent Range	Number of Responses	Percent of Responses	Percent of Respondents*
0 to 2	2	9	11
3 to 5	7	32	37
6 to 10	5	24	26
11 to 15	2	9	11
Over 15	3	13	16
No Response	3	13	--
Total	22	100	101

*may not total 100 percent because of rounding

Responses were received from 19 (87 percent) organizations. Slightly over one-third indicated that 3 to 5 percent level of savings was needed. About one-fourth indicated that 6 to 10 percent was needed. Less than 20 percent of the other responses indicated 0 to 2 percent, 11 to 15 percent, or over 15 percent as being needed. Over 60 percent indicated savings of between 3 and 10 percent were needed to successfully implement the self-funded health insurance plan.

Table 14 indicates the extent of each of the methods used in financing the self-funded health insurance plan. Slightly under 50 percent used the 501(c)(9), Trust or Other Type of Reserve Fund. Slightly less than 30 percent used a combination of cash flow and reserve fund. Slightly less than 20 percent used daily cash flow. The remaining 9 percent of the respondents stated the following: other described (1) use of a reserve fund that accumulated by premiums over claims and the amount designated from the general fund and (2) releasing a number of dollars twice a month for payment of claims.

Table 14

Methods of Financing the Health Care Plan

Financing Method	Number of Responses	Percent of Responses
Daily Cash Flow	4	18
501(c)(9), Trust or Other Reserve Fund	10	46
Combination of Cash Flow and Reserve Fund	6	27
Other	2	9
Total	22	100

Table 15 indicates the amounts of specific individual stop-loss insurance purchased by the organization. Over 80 percent of the respondents indicated that over $25,000 of specific individual stop-loss insurance was purchased. Less than 20 percent indicated purchase of $15,000 to $24,999 of stop-loss insurance. No response indicated less than $15,000.

Table 15

Amounts of Specific Individual Stop-Loss Insurance Purchased

Insurance Ranges	Number of Responses	Percent of Responses	Percent of Respondents
$10,000 to $14,999	0	0	0
$15,000 to $19,999	1	5	6
$20,000 to $24,999	2	9	12
$25,000 to $29,999	7	31	41
Over $30,000	7	31	41
Not Applicable	5	24	---
Total	22	100	100

Table 16 indicates the percent ranges of aggregate stop-loss insurance purchased. The largest percentage (60) of responses indicated that the amount of aggregate stop-loss insurance was purchased, but the amount was unknown. The aggregate stop-loss insurance purchased by the greatest percentage (20) was 116 to 120 percent. The next highest category (121 to 125 percent) was purchased by 10 percent of the organizations. The other categories (110 to 115 percent and over 130 percent) were each purchased by only 5 percent of the organizations.

Table 16

Amounts of Aggregate Stop-Loss Insurance Purchased

Percent of Insurance	Frequency of Responses	Percent of Responses	Percent of Respondents
110 to 115 Percent	1	5	5
116 to 120 Percent	4	18	20
121 to 125 Percent	2	9	10
Over 130 Percent	1	5	5
Amount Not Known	12	54	60
Not Applicable	2	9	--
Total	22	100	100

Table 17 indicates average percent ranges of savings on the projected health insurance premium by providing the self-funded health insurance plan. Two ranges of savings percentages (6 to 10 and over 15) were each indicated by 27 percent of the respondents. Two ranges of savings percentages (3 to 5 and 11 to 15) were each indicated by 9 percent of the respondents. The range 0 to 2 percent was indicated by only 5 percent of the respondents. The remaining respondents (23 percent) indicated that the average savings percent was unknown.

Table 17

Average Savings Percent of the Projected Health Insurance Premium

Percent Range	Number of Responses	Percent of Responses
0 to 2	1	5
3 to 5	2	9
6 to 10	6	27
11 to 15	2	9
Over 15	6	27
Unknown	5	23
Total	22	100

Item nine requested a response as to whether the organization established a 501(c)(9) trust fund for the self-funded health insurance plan reserve. Responses indicated that eight (36 percent) organizations had established a 501(c)(9) trust fund for reserves. Those organizations that had established a 501(c)(9) trust indicated that conversion privileges were handled in the following ways:

1. Convert directly with third-party insurer within 30 days of termination.

2. Conversion not available.

3. Conversion to carrier outside of group.

Item ten requested a response as to whether conversion privileges included a stop-loss contract. Responses indicated that two of the organizations included a stop-loss contract.

Table 18 indicates the number of years that the organization had self-funded the health insurance plan. Of the organizations surveyed, 27 percent had self-funded for one to two years, 32 percent had self-funded for three to five years, and 41 percent had self-funded for over five years. This indicates an increasing trend toward self-funded health insurance plans.

Table 18

Number of Years Organizations Self-Funded

Number of Years	Number of Responses	Percent of Responses
1 to 2	6	27
3 to 5	7	32
Over 5	9	41
Total	22	100

Table 19 indicates the frequency of the organization's increases in the self-funded health insurance premium. The largest percentage of organizations (41) indicated that there was no increase in the self-funded health insurance premiums. Another 27 percent indicated the organization increased premiums annually. The once in four years and other premium increases were each indicated by less than 10 percent of the respondents. No respondent indicated a biennial premium increase. Three organizations responded that the premium increase was not

Table 19

Frequency of Self-Funded Health Insurance Premium Increase

Frequency of Increase	Number of Responses	Percent of Responses
Annually	6	27
Biennial	0	0
Once in 4 Years	2	9
Other	2	9
No Increase	9	41
Not Applicable	3	14
Total	22	100

applicable because the self-funded health insurance plan was recently initiated (see Table 18).

Table 20 indicates the frequency of the organization's decreases in self-funded health insurance premium. The largest percentage of organizations (23) indicated that there was no decrease in the self-funded health insurance premium. Another 18 percent indicated a decrease in the premium once in four years. Another 14 percent indicated an annual decrease in the premium. No organization indicated a biennial or other frequency of premium

Table 20

Frequency of Self-Funded Health Insurance Premium Decrease

Frequency of Decrease	Number of Responses	Percent of Responses
Annually	3	14
Biennial	0	0
Once in 4 Years	4	18
Other	0	0
No Decrease	5	23
Not Applicable	10	45
Total	22	100

decrease. Almost half (45 percent) of the organizations indicated a not applicable response which probably indicates an experience with the self-funded health insurance plan of less than four years.

Table 21 indicates the percent of employee contribution towards the health insurance plan. Responses for 0 percent and 1 to 5 percent employee contribution to the health insurance plan were indicated by 23 percent respectively. Responses to 11 to 20 percent and 21 to 30 percent employee contribution were

Table 21

Percent of Health Insurance Plan Contribution by the Employee

Range of Percent Employee Contribution	Number of Responses	Percent of Responses
0 Percent	5	23
1 to 5 Percent	5	23
6 to 10 Percent	3	14
11 to 20 Percent	4	18
21 to 30 Percent	4	18
Over 30 Percent	1	4
Total	22	100

indicated by 18 percent respectively. Responses for 6 to 10 percent were made by 14 percent of the organizations. Employee contributions of over 30 percent were indicated by only 4 percent of the organizations. Almost half of the responses indicated the employee contributed 5 percent or less of the total health care premium.

Item 15 requested a response indicating whether health insurance was a negotiable item in the organization. Responses indicated that 12 organizations (55 percent) negotiated the health insurance benefit.

Item 16 requested a response indicating as to whether the organization had encountered any problems with the union regarding joint benefit administration. Three organizations indicated that problems were encountered in the following areas:

1. Initial acceptance of self-funded health insurance.
2. The union wants to implement their own insurer in the plan.
3. Understanding changes in the plan.

Item 17 requested a response indicating criteria organizations used in selecting a third party for administration of the self-funded health insurance plan. Almost two-thirds

(64 percent) indicated that a number of criteria were used in selecting the third party insurer/administrator. The criteria included:

1. Cost and services.
2. Accuracy, promptness, and efficiency.
3. Bid process with benefit program, administrative costs, and knowledge of self-funded health insurance.
4. References, nationwide capabilities, regional offices, and reporting capabilities.
5. Claims administration capability.
6. Timely payments.
7. Quality of service and proven ability to effectively administer a self-funded health insurance plan.

Table 22 indicates the services provided by an administrative services only (ASO) self-funded health insurance plan. All organizations indicated a subscription to more than one service. Those services subscribed to by 50 percent or more of the organizations included: (1) claims handling and review (82 percent), (2) booklets/certificates (73 percent), (3) enrollment (55 percent), and (4) conversion (50 percent). The remaining services were subscribed to by 45 percent or less of the organizations.

Table 22

Services Provided by an Administrative Services Only (ASO)

Services	Number of Responses	Percent of Responses
Enrollment	12	55
Contracts	10	45
Booklets/Certificates	16	73
Actuarial Services	8	36
Legal Services	3	14
Conversion	11	50
Claims Handling and Review	18	82
Cost-Containment Adjustment	7	32
Other	2	9

Item 19 requested a response to indicate other cost-containment measures that the organization had implemented. Responses indicated that 15 (68 percent) organizations had implemented other cost-containment measures that were described as:

1. Offered "Fit for Life" program to employees.
2. Quarterly meetings with employees.

3. Mandatory second opinion, hospice and home health coverage, 90 percent-10 percent major medical deductible, $25 patient deductible, 100 percent outpatient surgery.

4. Preadmission testing at 100 percent.

5. Deductibles, hospital room fixed rate, elimination of chiropractic coverage, subrogation clause, coordination of benefits clause, and coinsurance.

6. Birthing center.

7. Initial annual review of dependent eligibility.

8. Offer to refund percent of errors found on medical bills, change in benefits, emergency care usage, lab and x-ray changes to major medical.

9. Continued hospital stay certification.

10. Addition of two HMOs.

11. Alcohol and drug abuse--approved facility and peer review for hospital confinement.

Item 20 requested a response indicating difficulties the organization had in implementing the self-funded health insurance plan. Responses indicated that eight (36 percent) organizations experienced some difficulties that were described as:

1. Those difficulties inherent in the collective bargaining process.

2. Initially convincing the carrier that a tailor-made plan was needed--not a "standard" type.

3. Wellness program.

Item 21 requested a response indicating benefits, other than cost savings, that have resulted from implementing the self-funded health insurance plan. Responses indicated that 14 (64 percent) organizations derived other benefits from implementing the self-funded health insurance plan and were described as:

1. Very complete monthly reports and up-to-date knowledge as to what is happening with our medical program.

2. Significantly increased awareness of cost of health care and more selective utilization of services (i.e., services used when necessary)--significant reduction of claims.

3. Ability to set our own rates, thus avoiding premium increases yearly. Overall financial picture of health insurance costs.

4. Control, flexibility, and custom design.

5. Ease of plan management.

6. Flexibility to change plan structure, control of payments, control over decisions as to payments of benefits in unique cases, better claims processing, direct relations with employees regarding claims.

7. Elimination of the roller coaster effect of insurance premium increases.

8. Employee involvement--they learn, read, and are aware.

9. Group is more knowledgeable.

10. Faster claims payment.

11. Cash flow.

12. Judgments can be made on facts.

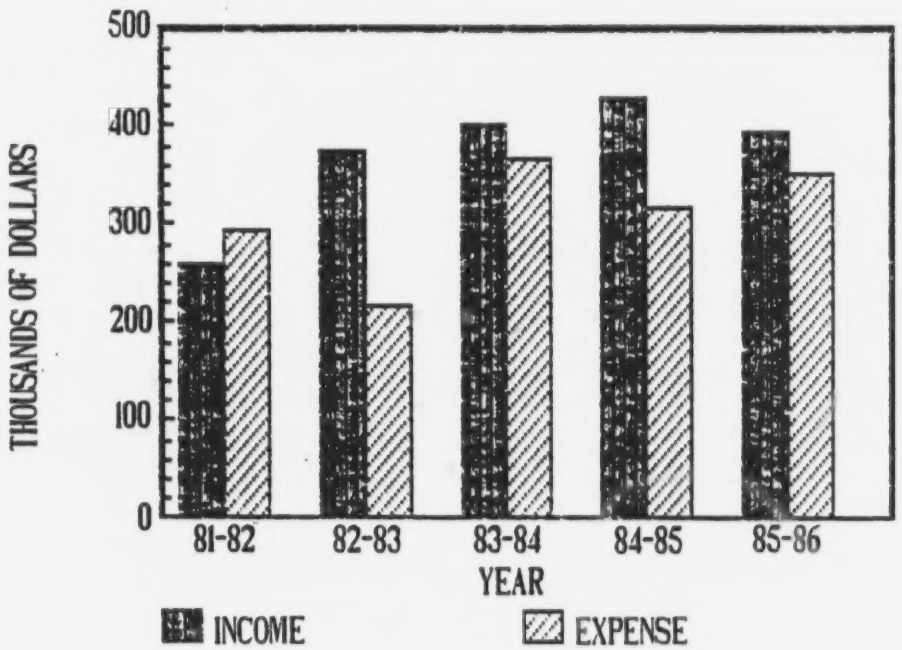
Income and Expense Data

Several financial analyses were made to assist LTI in determining whether the organization could finance a self-funded health insurance plan. LTI's income and expense data for the health insurance plan were collected for each of the years from 1981 through 1985. LTI's ability to finance fluctuations in income and expenses necessitated this analysis. Average income and expenses were calculated for each year. The projections for each of the years 1986 through 1990 were made based on the analyses of the income and expense data and the hypotheses stated on page 17. The three figures and the discussions on the following pages are used to illustrate the analyses.

Figure 1 indicates the amount of income received by the health insurance carrier from LTI for each of the years 1981 through 1985. It also indicates the amount of expenses paid by the health insurance carrier for each of the years 1981 through

Figure 1

Comparison of Health Insurance Income and Expense for the Period 1981-1986



1985. Expenses exceeded income only in fiscal year 1981-1982. Income continued to increase from year to year while expenses fluctuated below the level of income for each of the years 1982 through 1985.

The average ratio (R) of income to expense is based on the information presented in Figure 1 given the formula:

$$R = \frac{\text{Expense}}{\text{Income}} = \frac{1,546,981}{1,858,767} = \frac{0.832}{1.0} \text{ or}$$

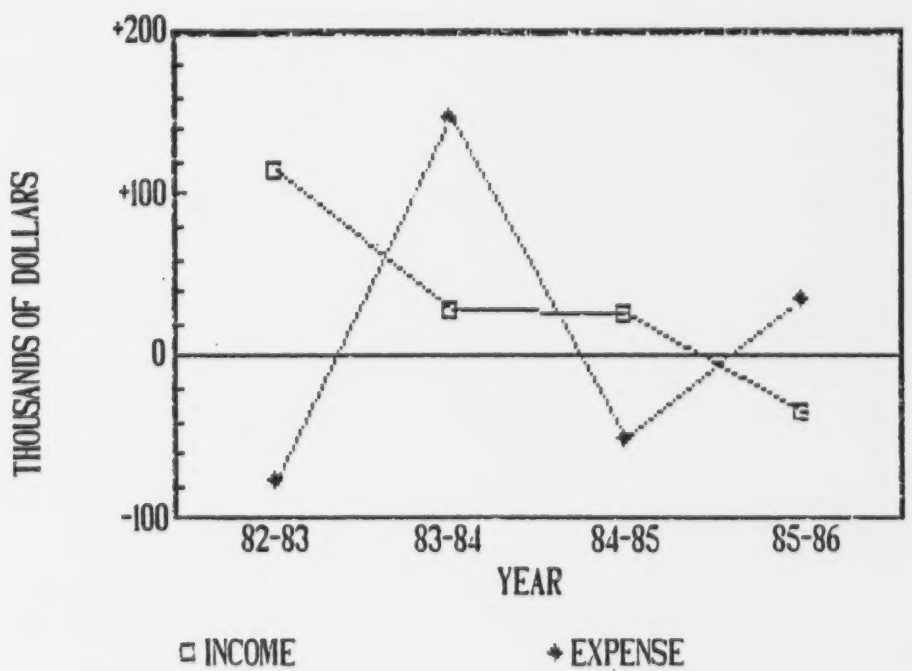
R (income:expense) = 1.0:0.832

The results indicate that LTI had paid more income to the health insurance carrier than the carrier paid out in incurred expenses.

Figure 2 indicates the yearly increase/decrease in health insurance income and expense for each of the years 1982 through 1985. Average annual increases in income and expense were

Figure 2

Yearly Increase/Decrease in Health Insurance Income and Expense for the Period 1982-1985

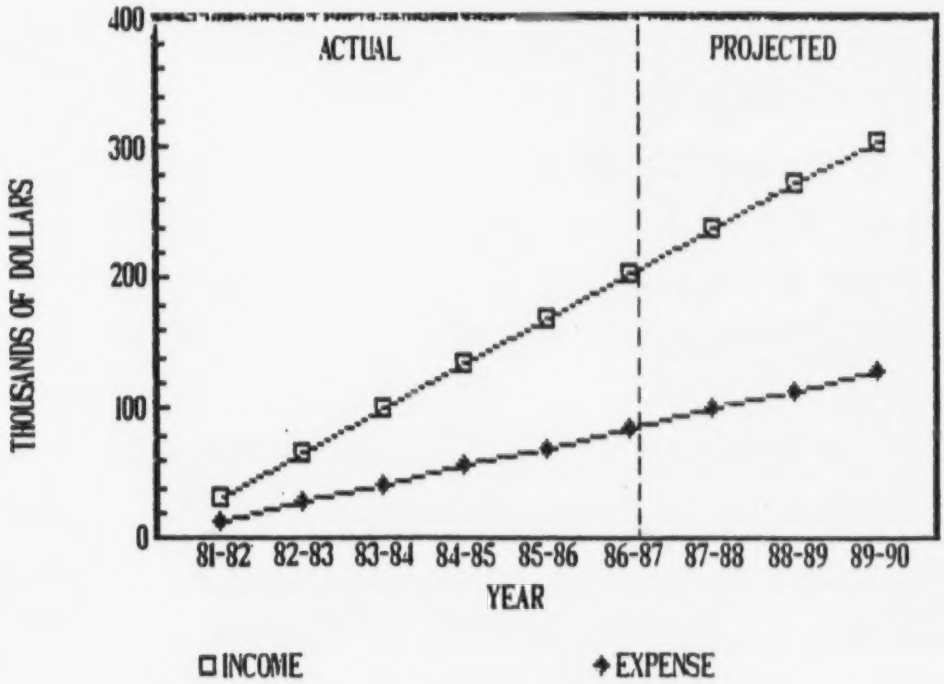


determined by this financial analysis. LTI experienced an unusually large increase in health insurance premium (income) in 1982-1983 to compensate for a large loss in 1981-1982 (see Figure 1). Expenses in 1982-1983, however, were substantially lower than in 1981-1982. In the years 1983-1984 and 1985-1986, the change in expenses exceeded the change in incomes. In the year 1984 to 1985, the change in income exceeded that of the expense. The average change in premium (income) was $34,008 (9.14 percent) per year. The average change in expense was $14,371 (4.64 percent) per year. The results indicate that there was a considerable average annual difference between income paid to the carrier and the expenses paid by the carrier.

Figure 3 indicates the average income and expense projections for each of the years from 1986 through 1990. Results from the finanacial analyses illustrated in Figure 2 provided the bases for these projections. The projections indicate that income will surpass expenses by $176,733 in the year 1990. The ratio (R) of income to expense in the year 1990 will be $R = \frac{129,339}{306,072} = 1.0:0.423$ assuming current income and expense rates will continue. The results indicate that there was a considerable difference in income paid to the carrier than the carrier had paid out for incurred expenses.

Figure 3

Analysis and Projections of Health Insurance Income and Expense for the Period 1981-1990



Summary, Conclusions, and Recommendations

The study was undertaken to determine whether the self-funded health insurance plan was a viable health insurance alternative for LTI. The viability decision was to be based on differences between the projected costs (claims and other expenses) and projected income (premiums) between the conventional and the self-funded health insurance plans. In addition, other factors relating to the decision were also studied.

A number of specific procedures were identified for inclusion in the study. These included selection of a sample, survey of respondents, tabulation, collection, and analysis of data. The results of the analysis were used to provide information for answering the research questions.

The sample was selected from business, industry, government, and educational organizations located in the central and eastern areas of Wisconsin. Factors used in the selection of this sample included: (1) numbers of employees, (2) numbers of subscribers, and (3) contracts for specific types of self-funded health insurance plans. The sample numbered 24 organizations.

A mail-type survey was used to obtain information from sample respondents in a number of areas. These areas included:

1. Types of self-funded health insurance plans and number of years in the plan.

2. Major factors used in selecting self-funded health insurance.

3. Level of savings and cost savings factors.

4. Methods of financing.

5. Amounts of specific individual stop-loss insurance and aggregate stop-loss insurance purchased.

6. Average savings percent of the projected health insurance premium.

7. Services provided by the third-party insurer/ administrator.

8. Other benefits derived from implementing the self-funded health insurance plan.

Responses were obtained from 22 (92 percent) organizations. This was a sufficiently high response rate for using the data as the bases for making the decisions. Of the respondents, 14 were from industry, 4 were from education, and 2 each were from business and government. Respondents in 82 percent of the organizations indicated that the number of subscribers to the self-funded health insurance plan were within the range of 150 to 449.

The data were tabulated and analyzed with the following results:

1. Responses indicated that 55 percent of the organizations surveyed purchased the Administrative Services Only (ASO) type of self-funded health insurance plan.

2. Almost 50 percent of the respondents indicated that the method used to finance the health care plan was a 501(c)(9) Trust or Other Reserve Fund.

3. The minimum amount of specific individual stop-loss insurance purchased of $25,000 was indicated by 82 percent of the respondents.

4. Amounts of aggregate stop-loss insurance purchased were between 116 to 125 percent of the annual cost of health insurance.

5. The average savings percent of the projected health insurance premium range of 6 to over 15 percent was indicated by 60 percent of the respondents.

6. Almost 75 percent of the respondents indicated that the self-funded health insurance plan had been in effect for over three years.

7. The largest segment of respondents (41 percent) indicated that there had been no increase in the self-funded health insurance premium.

8. Almost 50 percent of the respondents indicated that employees contributed 5 percent or less of the health insurance premium.

9. Almost 64 percent of the respondents indicated that a number of criteria were used in selecting the third-party insurer administrator. These included cost and services; accuracy, promptness, and efficiency; claims administration capability; timely payments; and quality of service.

10. At least 50 percent of the respondents subscribed to more than one service provided by Administrative Services Only (ASO). These included claims handling and review, booklets/certificates, enrollment, and conversion.

11. A majority (64 percent) of the respondents indicated that other benefits were also derived from the self-funded health insurance plan. These included complete monthly reports, ability to set own rates, control, custom design, cash flow, faster claims payment, and employee awareness/involvement.

Specifically, there were four factors found to be most important in the viability decision to self-fund the health insurance plan. The respondents were requested to rate the importance of each of the factors from most important to not applicable. Analyses produced the following:

1. Almost 50 percent of the respondents surveyed indicated that financial reserve considerations and flexibility were of average to most important.

2. Almost 70 percent of the respondents indicated that accessibility to and use of claims data for decision making were of average to most important.

3. Almost 60 percent of the respondents indicated that elimination of many carrier charges were of high to most important.

4. At least 85 percent of the respondents indicated that savings on health care costs were of high to most important. In addition, 89 percent of the respondents indicated that the minimum level of savings necessary to successfully implement the self-funded health insurance plan was 3 percent.

Another area included in the study was income and expense data. A determination as to whether LTI could finance the self-funded health insurance plan was made from reviewing several financial analyses. These included income and expense data comparisons for each of the years from 1981 through 1985. The average income and expenses were calculated for each of these years. Finally, projections based on the income and expense data analyses were made for each of the years 1986 through 1990.

Income surpassed expenses for each of the years 1981 through 1985, except in 1981. LTI's average ratio (R) of income to expense during this period was R = 1.0:0.832.

Further analyses included the yearly increase/decrease in health insurance income and expense for each of the years 1981 through 1985. The average change in premium (income) was $34,008 (9.14 percent) per year. And the average change in expense was $14,371 (4.64 percent) per year.

Using the average income per year of $34,000 and the average expense per year of $14,371 for the period 1981 through 1985, projections were made for each of the years from 1986 through 1990. Based on the projections, income will surpass expenses by $176,711 in the year 1990. Assuming current income and expense rates will continue, the ratio (R) of income to expense in the year 1990 will be R = 1.0:0.432.

Conclusions

Upon review of the literature and the results of the study, a number of important conclusions were made. A number of organizations, similar in size to that of LTI, have successfully implemented the self-funded health insurance plan. The number seems to be increasing each year.

It appears that the self-funded health insurance plan is a viable alternative to containing health care costs in business,

industry, government, and educational organizations. Organizations having between 150 to 449 eligible employees tended to select the partially self-funded health insurance plan. The organizations tended to have a third-party insurer/administrator providing administrative services and stop-loss insurance protection. Finally, similar types of organizations had similar health insurance costs and abilities to finance these costs.

Other conclusions were made in the areas of financing a self-funded health insurance plan. The projection for an average premium increase of approximately 10 percent for each of the years from 1986 through 1990 is realistic. Based on the financial analysis of increases/decreases in income and expense found in Figure 2, the average annual change in premium (income) was $34,008 (9.14 percent) per year for each of the years 1982 through 1986. Upon reviewing the literature, a realistic projection of the annual average increase in health care costs is approximately 8 percent. According to Stone and Reitz, during the 16-year period, 1965 through 1981, medical costs rose at an annual rate of 7.7 percent.

There were a number of important factors and related responses that served as the bases for making the decisions as to whether self-funded health insurance was or was not a viable alternative for LTI. Following are the considerations respondents

indicated most important in making a decision to self-fund or not the health insurance plan:

1. Financial Reserve Considerations and Flexibility: This was important because claims (expenses) lag behind income, and the organization has more control over the reserves (monetary set-asides). Having a reserve fund does not necessitate that claims be taken out of the current budget. (See Figure 2 for fluctuation of claims.)

2. Accessibility to and Use of Claims Data for Decision Making: Under a conventional health insurance plan, the organization has access to limited information regarding health conditions and claims. Under a self-funded health insurance plan, access to this information enables the organization to review data and make decisions regarding alternative cost-containment measures while providing the same levels and types of health protection.

3. Elimination of Many Carrier Charges: As indicated in the review of the literature section, a number of individual costs make up the total cost of health care. These costs are passed along to the organization from the health insurance carrier. Included are costs for claims paid, reserves for excessive claims, reserves for incurred but unpaid claims, administrative expenses, and profit. When self-funding the health insurance plan, the

organization has more flexibility in managing these costs, thereby reducing or eliminating many of these costs.

4. Savings on Health Care Costs: There are a number of savings areas found in self-funding the health insurance plan. These include interest gained by not paying premiums in advance of claims, retention (approximately 10 percent of the total premium cost involves margin for claim fluctuation), the interest paid on reserve fund monies, and cash flow flexibility (determining when claims are paid).

5. Level of Savings Needed to Successfully Implement Self-Funded Health Insurance: Over 60 percent of the respondents indicated that the minimum range of savings should be between 3 and 10 percent if the organization is to self-fund the health insurance plan successfully. The range of 6 to 15 percent savings was considered average.

6. Methods of Financing the Health Care Plan: The most popular method of financing the self-funded health insurance plan was a 501(c)(9) Trust or Other Reserve Fund. This is a monetary reserve fund established to provide reserve funds to pay actual and incurred claims. Employer contributions to the fund are tax-deductible, and the interest earnings on reserves are tax-exempt.

7. Amounts of Specific Individual Stop-Loss and Aggregate Stop-Loss Insurance Purchased: When considering self-funding the

health insurance plan, the responsibility for administering the health insurance functions changes. The liability shifts from the carrier back to the organization. Purchasing catastrophic liability insurance protects the organization in two ways. First, specific individual stop-loss insurance caps the organization liability for paying individual claims. Second, aggregate stop-loss insurance caps the total annual payout for health insurance benefits. The majority of respondents indicated that a minimum of $25,000 of specific individual stop-loss insurance and a minimum of 116 percent of the annual cost of health insurance was necessary in order to consider self-funding.

8. Number of Years Organizations Self-Funded: The majority of respondents indicated that the self-funded health insurance plan had been in effect in the organization for at least three years. This indicates an increasing trend towards self-funding the health insurance plan in small- to medium-size organizations. It also indicates successful implementation of such a plan.

9. Frequency of Self-Funded Health Insurance Premium Increase: Almost 50 percent of the respondents indicated that there had been no increase in the premium since the plan's implementation. This indicates that health insurance functions and costs can be controlled in an organization.

10. Percent of Health Insurance Plan Contribution by the Employee: Almost 50 percent of the respondents indicated that employees contributed 5 percent or less toward the health insurance premium. These results are similar to LTI's employee contribution level. This indicates that the major benefactor of health care cost containment is the organization.

11. Health Insurance as a Negotiable Item: Over 50 percent of the respondents indicated that health insurance was a negotiable item. The results indicated that self-funding the health insurance plan is possible and has been successful in a union environment.

12. Selecting a Third-Party Insurer/Administrator: A number of criteria were used and should be considered in selecting the third-party insurer. Included are: cost and services, accuracy, references, reporting capabilities, claims administration, timely payments, quality of service, and proven ability to effectively and efficiently administer a self-funded health insurance plan. The third-party insurer is needed when implementing a partially self-funded plan.

13. Benefits, Other Than Cost Savings From Implementing the Self-Funded Health Insurance Plan: Over 60 percent of the respondents indicated other benefits were derived from implementing the self-funded health insurance plan. Included

were: monthly reports, increased awareness of health care costs and more selective utilization of services, ability to set rates (premiums), custom design of plan, ease of plan management, and flexibility to change plan structure and implement more cost-savings measures.

Financial positioning was a high importance factor in determining the feasibility of implementing a self-funded health insurance plan. Based on the analysis of income and expense data for each of the years 1981 through 1985, projections were made for each of the years 1986 through 1990. During the first five-year period, the average ratio (R) of income to expense was R = 1.0:0.832. Based on the projections made for the five-year period, 1986 through 1990, the average ratio (R) of income to expense in the year 1990 will be R = 1.0:0.423. LTI's decision to self-fund the health insurance plan would be viable because the total increase in expenses is projected to be less than 50 percent of the total increase in income. Another conclusion was that the frequency and percentage of premium increases under a self-funded health insurance plan would decrease. As a result, more monies could be placed in the reserve fund to handle fluctuations in health insurance expenses without placing a hardship on the organization or the employee.

Recommendations

Based on the study, LTI appears to be in a good position to partially self-fund the health insurance plan. In considering implementing the self-funded health insurance plan at LTI, the following are recommended:

1. That LTI consider a partially self-funded health insurance plan in which administrative services are provided by a third-party insurer/administrator.

2. That the type of partially self-funded health insurance plan considered be an Administrative Services Only (ASO).

3. That a legal reserve fund be researched and identified that would meet governmental accounting guidelines.

4. That further research be conducted regarding the LTI history of individual claims to determine whether specific individual stop-loss insurance should be purchased and at what amount.

5. That further research be conducted regarding the LTI history of total annual health insurance costs to determine the level of aggregate stop-loss insurance to be purchased.

6. That all projected costs and income associated with a partially self-funded health insurance plan be analyzed, and the decision to self-fund or not be based on a minimum savings level of 8 percent.

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Appendix A

"the most Important Choice you'll ever make..."
Lakeshore Technical Institute
FREDERICK J. NIERODE
District Director
75

1290 North Avenue Cleveland, WI 53015-9761 PHONE (414) 458-4183 or 684-4408

April 17, 1986

ATTENTION PERSONNEL MANAGER

Dear Sir or Madam:

I am investigating the feasibility of implementing a self-funded health insurance plan at the Lakeshore Technical Institute (LTI). This is in an effort to review alternatives to contain health care costs. To collect related data for the study, I am attempting to determine the types of insurance coverage that organizations in the lakeshore area currently provide.

Please complete the enclosed card and return it to the Personnel Department at LTI by April 25, 1986. An additional form may follow to selected organizations.

Thank you for your cooperation and assistance in this study. If you have any questions, feel free to contact me at 458-4183 or 684-4408, extension 144.

Sincerely yours,

Karen E. Holstein

Karen E. Holstein
Personnel Specialist/Affirmative Action

KEH:daj

Enclosure

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1290 North Avenue
CLEVELAND, WI 53015-9990

ATTENTION PERSONNEL DEPARTMENT

LTI SELF-FUNDED HEALTH INSURANCE STUDY

Please check all the types of health insurance you offer to your employees as a benefit.

_____ Conventional Health Insurance
_____ Health Maintenance Organization (HMO)
_____ Preferred Provider Organization (PPO)
_____ Self-funded Health Insurance

Person Responding _____

Title _____

Organization _____ Phone _____

Approximate # of Employees (full- and part-time)_____

Approximate # of Health Insurance Subscribers _____

A SELF-FUNDED HEALTH INSURANCE QUESTIONNAIRE
Lakeshore Technical Institute
May 1986

Place a check mark in front of the most correct answer(s), circle the rating, and/or write a response.

1. How many of your employees are eligible for the health insurance benefit in your organization?

   ____ 150-249 ____ 250-349 ____ 350-449 ____ Over 449

2. What type of self-funded health insurance plan do you have?

   ____ Administrative Services Only (ASO)
   ____ Cost-Plus
   ____ Minimum Premium
   ____ Self-Administered
   ____ Other (specify) _____

3. How important was each of the following factors in selecting the plan indicated in number 2.

   A. Elimination of the state premium taxes.

0	1	2	3	4	5
N/A	Least				Most

   B. Tax-free earnings on reserves (monies set aside for payment of claims).

0	1	2	3	4	5
N/A	Least				Most

   C. Financial reserve considerations and flexibility.

0	1	2	3	4	5
N/A	Least				Most

   D. Tax-exemption of investment earnings.

0	1	2	3	4	5
N/A	Least				Most

   E. Accessibility to and use of claims data for decision making.

0	1	2	3	4	5
N/A	Least				Most

   F. Elimination of many carrier charges.

0	1	2	3	4	5
N/A	Least				Most

G. Greater flexibility in determining employee contribution level.

0	1	2	3	4	5
N/A	Least				Most

H. Savings on health care costs.

0	1	2	3	4	5
N/A	Least				Most

I. Employee acceptance.

0	1	2	3	4	5
N/A	Least				Most

4. What level of savings do you feel is necessary to successfully implement self-funded health insurance?

_____ 0-2 percent _____ 3-5 percent _____ 6-10 percent
_____ 11-15 percent _____ Over 15 percent

5. Which of the following methods are used to finance the health care plan?

_____ A. Daily cash flow; no reserve; borrowing to pay claims when necessary.
_____ B. 501(c)(9) trust or other type of reserve fund.
_____ C. Combination of cash flow and reserve fund.
_____ D. Other (please describe)

_____

_____

_____

6. Do you purchase specific individual stop-loss health insurance?

_____ Yes _____ No

If yes, what specific stop-loss insurance amount was purchased?

_____ $10,000-$14,999 _____ $25,000-$29,999
_____ $15,000-$19,999 _____ Over $30,000
_____ $20,000-$24,999

7. Do you purchase aggregate stop-loss insurance?

_____ Yes _____ No

If yes, what percent of aggregate stop-loss insurance has been purchased?

_____ None _____ Don't know
_____ Percent of total annual claim costs

8. On an average, what percent of the projected health insurance premium has been saved by self-funded health insurance?

_____ 0-2 percent _____ 3-5 percent _____ 6-10 percent
_____ 11-15 percent _____ Over 15 percent

9. Have you established a 501(c)(9) trust fund for reserves?

_____ Yes _____ No

If yes, how do you handle conversion privileges?

_____

_____

_____

10. Do the conversion privileges include a stop-loss contract?

_____ Yes _____ No

11. For how many years have you self-funded your health insurance plan?

_____ 1-2 _____ 3-5 _____ Over 5

12. How often have you increased the self-funded health insurance premium?

_____ No increase _____ N/A _____ Annually
_____ Bienniel _____ Once in 4 years _____ Other

13. How often have you decreased the self-funded health insurance premium?

_____ No decrease _____ N/A _____ Annually
_____ Bienniel _____ Once in 4 years _____ Other

14. What percent of the health insurance plan is paid by the employee?

_____%

15. Is health insurance a negotiable item in your organization?

_____ Yes _____ No

16. What problems have you encountered with the union regarding joint benefit administration?

_____

_____

_____

_____ N/A

17. What criteria did you use in selecting a third party for administration of the self-funded health insurance plan? _____ N/A

_____

_____

_____

_____

_____

_____

18. Which of the following are provided by your ASO? (Check all that apply.)

_____ Enrollment
_____ Contracts
_____ Booklets/certificates
_____ Actuarial services
_____ Legal services
_____ Conversion
_____ Claims handling and review
_____ Cost-containment adjustment
_____ Other (specify) _____

19. What other cost-containment measures have you implemented?

_____

_____

_____

20. What difficulties did you have in implementing the self-funded health insurance plan?

_____

_____

_____

_____

_____

_____

21. What benefits, other than cost savings, have resulted from implementing the self-funded health insurance plan?

_____

_____

_____

_____

_____

_____

Please send a copy of your self-funded health insurance benefit booklet to assist in clarifying information.

Would you like a copy of the survey results? _____ Yes _____ No

Administrative Services Only (ASO) -- A self-funded health insurance plan whereby the contract is written by the organization, and the carrier/insurer agrees to abide by the organization's contractual requirements.

Aggregate Stop-Loss Insurance -- Insurance purchased by the organization that caps the total annual payout for health insurance benefits, usually at an amount calculated between 110 percent and 125 percent of the organization's total annual estimated claims cost.

Cash Flow -- Claims paid from daily operating income and borrowing money when necessary to pay claims.

Cost-Plus -- A self-funded health insurance plan whereby the contract is written by the carrier, and the organization assumes the regulations imposed by the carrier and the state insurance commissioner.

Joint Benefit Administration -- A self-funded health insurance plan provided for union-represented employees that is jointly administered by the organization and the union.

Minimum Premium Plan -- A plan similar to a conventional health insurance plan with the exception that the carrier and the organization agree to assume a specified share of the claims liability. Generally, the organization's liability is 10 percent of expected claims.

Reserve Fund -- A monetary fund established to set aside reserves that are used to cover outstanding health insurance expenses.

Self-Administered -- A self-funded health insurance plan that is written and administered by the organization, provides its own claims administration, and no carrier is involved.

Self-Funded Health Insurance -- A self-funded health insurance plan whereby the organization assumes the risk for claims incurred and claims paid and contracts with a third-party insurer/administrator to provide administrative services only.

Specific Stop-Loss Insurance -- Insurance purchased from a carrier in conjunction with claims administration that protects the self-insured organization against excessive individual claims.

Stop-Loss Insurance -- Insurance purchased from a carrier in conjunction with claims administration that protects the self-insured organization against excessive claims, either on an aggregate basis or on an individual-case basis.

Third-Party Insurer/Administrator -- Any company that an organization contracts with to pay insurance claims and performs a full complement of administrative services.

501(c)(9) Trust Fund -- A monetary reserve fund established by the organization using Internal Revenue Code guidelines to provide reserve funds for self-funded health insurance. The employer contributions are tax-deductible as a cost of doing business. Also, earnings on these reserves are tax-exempt.

Appendix E

the most Important Choice you'll ever make...

Lakeshore Technical Institute

FREDERICK J. NIERODE
District Director

1290 North Avenue Cleveland, WI 53015-9761 PHONE (414) 458-4183 or 684-4408

May 5, 1986

Dear ----------:

Thank you for responding to the Lakeshore Technical Institute (LTI) self-funded health insurance inquiry mailed to you on April 17, 1986. You have been selected to respond to a more detailed questionnaire because of your response to the self-funded health insurance practices in your organization.

The questionnaire is to collect related data for the self-funded health insurance study at LTI. The information will assist LTI in determining the feasibility of implementing this type of health insurance plan.

A definition list of terms used in the questionnaire and a five-page questionnaire are enclosed. Please complete the questionnaire and return in the enclosed envelope by May 16, 1986. I will telephone you during the week of May 19, 1986, if the completed survey has not been received or if further clarification is needed.

Thank you for your assistance in this matter.

Sincerely,

Karen E. Holstein
Personnel Specialist/Affirmative Action

KEH:jmb

Enclosures

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